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ARIOSA DIAGNOSTICS, INC.

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF CALIFORNIA
SAN FRANCISCO DIVISION

14 VERINATA HEALTH, INC.,) Lead Case No. 3:12-cv-05501-SI
15 Plaintiff and) Case No. 3:14-cv-01921-SI
16 Counterclaim-Defendant,) Case No. 3:15-cv-02216-SI
17 vs.)
18 ARIOSA DIAGNOSTICS, INC.,)
19 Defendant and)
20 Counterclaim-Plaintiff.)
21 ILLUMINA, INC.,)
22 Plaintiff and Counterclaim-)
23 Defendant)
24 vs.)
25 ARIOSA DIAGNOSTICS, INC.,)
26 Defendant and Counterclaim-)
Plaintiff.)
ARIOSA DIAGNOSTICS, INC.'S
RENEWED MOTION TO PRECLUDE
THE TESTIMONY OF JAMES E.
MALACKOWSKI RE: ALLEGED LOST
TEST FEES
Judge: Hon. Susan Illston

1 ILLUMINA, INC.,)
2 Plaintiff and Counterclaim-)
3 Defendant)
4 vs.)
5 ARIOSA DIAGNOSTICS, INC.,)
6 Defendant and Counterclaim-)
7 Plaintiff.)
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1 On January 4, 2018, the Court ruled on Defendant Ariosa Diagnostic, Inc.'s ("Ariosa")
 2 Motion to Preclude the Testimony of James E. Malackowski, the damages expert for Plaintiffs
 3 Ilumina, Inc. and Verinata Health, Inc. (collectively, "Plaintiffs"). *See* D.I. 561. In its order, the
 4 Court deferred decision on a number of Ariosa's objections to Mr. Malackowski's method of
 5 calculating a reasonable royalty and lost profits because the Court perceived a dispute over certain
 6 facts, which, if proven true, would preclude Plaintiffs from presenting various aspects of Mr.
 7 Malackowski's opinions to the jury. *See, e.g., id.* at pp. 5, 8.

8 Among the facts that the Court identified as disputed was the issue of whether Plaintiffs'
 9 alleged lost test fees are properly characterized as royalties. *Id.* at p. 8. The Court "deferr[ed]
 10 decision" on this issue "until after hearing evidence on Illumina's agreements with third parties."
 11 *Id.* The Court, however, made clear that if the alleged lost test fees are royalties, they are not
 12 recoverable. *Id.* at p. 7. As the Court explained, the Federal Circuit specifically held in *Warsaw*
 13 *Orthopedic, Inc. v. NuVasive, Inc.*, 778 F.3d 1365 (Fed. Cir. 2015), that "lost royalty payments
 14 were not recoverable," because "[t]o be entitled to lost profits, . . . the lost profits must come from
 15 the lost sales of a product or service the patentee *itself* was selling." *Id.* (citing *Warsaw*, 778 F.3d
 16 at 1376).

17 The trial testimony of Dr. Jeffery Bird, who was an executive officer at Verinata and then
 18 at Illumina, confirms that test fees are not "a product or service" but rather are being presented by
 19 Illumina in this trial as being equivalent to royalties:

20 **Q.** And this is referring to a **royalty opportunity**. So you're talking as Verinata to
 21 Illumina about selling Verinata to Illumina. What does royalty opportunity have
 22 [to] do with that?

23 **A.** So we were having a discussion with Illumina about the idea that they could
 24 use our intellectual property to broadly make the test available, and that **they**
 25 **could receive a royalty or a per patient test fee from their customers**, as they
 26 – as they made that test available. One of the things that Jay and the management
 27 team were worried about was competing with their customers. And they did not
 28 necessarily want to be in the business of making and selling the test the way
 Verinata was doing. And it seemed to be their preference, instead -- and we
 thought it was a reasonable idea, although it was a different business model than
 we had -- for us to potentially close the lab, and instead for them to license IP to
 lots of people to perform the tests. So this talks about financially what that might
 look like if you were to charge **a per-test fee, or you could also call it a royalty**.

1 Trial Tr. 235:24-236:18 (emphasis added).

2 Similarly, Dr. Nicholas Naclerio, another Illumina executive, also expressly presented the
3 test fees as royalties:

4 **Q.** Okay. And why do you prefer **the per-test fee structure for this large royalty**
5 – **this large licensing program** that you just said is one piece of supplying the
6 equipment?

7 **A.** It's -- there are a lot of factors that go into it. I think at the end of the day, it's a
8 relatively simple method. If – if – you know, **the alternatives are, we – we**
9 **calculate some kind of royalty based on sales ... So the simple thing for us was**
10 **just to say, “Look, we're going to get so much per test.”**

11 Trial Tr. 458:23-459:16 (emphasis added).

12 Finally, Plaintiffs' counsel, when seeking to offer a document purporting to summarize
13 aspects of various Illumina Supply Agreements, again confirmed that Illumina is presenting the
14 Supply Agreement test fees as “royalties,” stating **“we have many licensees who are paying per**
15 **test royalties.”** Trial Tr. 541:14-15 (emphasis added).

16 As the testimony from Drs. Bird and Naclerio and the arguments from Illumina's counsel
17 make clear, Illumina is affirmatively presenting in this trial the “test fees” charged to third parties
18 as “royalties.” As this Court has already recognized, under *Warsaw*, the profits that a third party
19 allegedly would have realized and would have remitted to the plaintiff but for the defendant's
20 infringement are not collectable as lost profits. *Warsaw*, 778 F.3d at 1376; Dkt. 561 at pp. 7-8
21 (“*Warsaw* appears analogous to the situation here.”). Thus, the portion of Mr. Malackowski's lost
22 profits calculation that rests on Illumina's lost test fees cannot be presented to the jury. It is critical
23 that this issue be resolved now, before Mr. Malackowski testifies, as presenting the alleged lost
24 test fee theory will skew the damages horizon and confuse the jury. This is particularly important
25 given that Mr. Malackowski is separately presenting a “reasonable royalty” theory at trial. *See*
26 *Uniloc USA, Inc. v. Microsoft Corp.*, 632 F.3d 1292, 1320 (Fed. Cir. 2011) (granting a new trial
27 after plaintiff's expert presented damages numbers to the jury that were based on legally flawed
28 theories because inaccurate numbers “cannot help but skew the damages horizon for the jury”).¹

¹ Ariosa continues to object to other aspects of Mr. Malackowski's opinions as set forth in Docket No. 418, which are also contrary to law and also skew the damages horizon for the jury. The Court deferred ruling on the admissibility of testimony from Mr. Malackowski on other issues

1 In summary, by affirmatively presenting testimony from Dr. Bird that the “per-test fee . . .
 2 could also [be] call[ed] . . . a royalty” and testimony from Dr. Naclerio that Illumina chose to
 3 structure its profits as royalties, Illumina has resolved the issue that this Court previously
 4 identified as open. Per Federal Circuit precedent and this Court’s previous order, the testimony
 5 from Drs. Bird and Naclerio and the arguments from Illumina’s counsel render Mr.
 6 Malackowski’s lost profits damages calculation legally erroneous and mandate that Mr.
 7 Malackowski be precluded from presenting these calculations to the jury. Ariosa therefore
 8 respectfully requests that the Court make the decision that it previous deferred and prohibit Mr.
 9 Malackowski from presenting lost profits calculations to the jury that include lost test fees.

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11 Dated: January 14, 2018

Respectfully submitted,

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IRELL & MANELLA LLP

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By: /s/ Sandra L. Haberny

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Attorneys for Defendant and Counterclaim-
Plaintiff ARIOSA DIAGNOSTICS, INC.

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as well. Ariosa expects to raise additional objections or seek other relief based on aspects of Mr. Malackowski’s damages testimony that lack a proper evidentiary basis and should not be considered or presented.